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ABSTRACT

This paper assesses the potential impact on the New York State economy, industries, and regions of the recently implemented Canada-U.S. Free Trade Agreement (FTA). Canadian trade and investment have had significant impacts on the economies of the United States and New York state. An analysis of the potential impact of the FTA on New York state, focusing on the industries and regions most affected, is provided. Suggested strategies and policies for industries, specific firms, and government to pursue in order to take advantage of potential benefits of the FTA and to mitigate any negative impacts are presented. Because of the state's historical position as a major trading and investment partner with Canada, its strategic position at the axis of the industrial corridor of the United States and Canada, and its diverse and productive economic structure, including a supportive and extensive government economic development program, New York is poised to reap significant benefits from the FTA agreement. (Author/DB)

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Free Trade for New York

The Economic Impact of the Canada-United States Free Trade Agreement on New York State

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NOTE: Research for this paper was undertaken during 1988 and 1989, the year prior to the Free Trade Agreement's implementation and the first year under the Agreement. This research has supported other publications by the author, including *Trade Across the Border: The Canada-U.S. Free Trade Agreement and Its Economic Impact on New York State* (published by the New York State Department of Economic Development) and, with Richard C. McGahey, "Effects of Freer Trade on New York State: Economic Impact and Policy Considerations" (in *Economic Opportunities in Freer U.S. Trade with Canada*, edited by Fredric C. Menz and Sarah E. Stevens. Albany, SUNY Press, forthcoming, pp. 101-120).

Abstract

This paper assesses the potential impact of the recently implemented Canada-U.S. Free Trade Agreement (FTA) on the economy, industries, and regions of New York. The author first explores the role of Canadian trade and investment in the economies of the U.S. and New York State; provides a brief overview of the provisions of the FTA and its national economic effects; analyzes potential impacts of the FTA on the economy of New York State, focusing on the industries and regions most affected; and suggests strategies and policies for industries, specific firms, and government to pursue in order to take advantage of potential benefits of the FTA and to mitigate any negative impacts. The author concludes that because of its historical position as a major trading and investment partner with Canada, its strategic position at the axis of the industrial corridor of the U.S. and Canada, and the diverse and productive economic structure of the State, including a supportive and extensive government economic development program, New York is poised to reap significant benefits from the agreement.

Introduction

After years of debate and a highly charged campaign, on November 21, 1988, Canadian voters affirmed their support of freer trade with the U.S., giving Prime Minister Brian Mulroney's Progressive Conservative party a majority in Canada's House of Commons. After approval by Canada's House of Commons and Senate, the Canada-U.S. Free Trade Agreement, originally signed on January 2, 1988, took effect as scheduled on January 1, 1989.

The Canada-U.S. Free Trade Agreement (FTA) is a significant milestone in the U.S.-Canadian trading relationship and for international trade in general. The FTA provides for the elimination of tariffs in three stages over ten years and makes significant inroads into the reduction of nontariff barriers and the liberalization of services trade. The FTA also sets up a truly innovative mechanism for the resolution of future trade disagreements by formalizing a process for consultation and adjudication to resolve recurring disputes. The FTA took two years to negotiate and resulted in a compromise agreement that does not fully address all concerns of either party. The agreement is, however, expected to result in increased economic growth, additional jobs, greater availability of diverse goods, more efficient production and lower prices in the U.S. and Canada.

For New York, most industries and regions will benefit, although in aggregate the benefits will be modest, especially when compared to other economic phenomena such as the fluctuation in business cycles. This is because of the enormous size of the American and New York State markets compared to Canada, the fact that trade already flows quite freely between the two countries and the slow, gradual effect of the ten-year staged elimination of tariffs.

Of industries that will benefit, the electronics, computer, photographic equipment and supplies, and financial and business services sectors should fare well under the new trading regime. These industries are competitively positioned and/or currently face high tariffs or

nontariff barriers in Canada. When barriers are removed, they will be well-situated to expand exports. Regionally, the FTA will have its greatest impact on northern and western New York, with some positive and negative outcomes resulting from the combination of effects on cross-border trade and investment.

On January 1, the first series of tariffs between the U.S. and Canada were eliminated on goods produced by some of New York's strongest manufacturing industries as part of the first phase of the FTA tariff elimination schedule. These include a 3.9 percent Canadian tariff on computers, data and word processors, and modems, a 10.3 percent tariff on satellites and telephone handsets, a 17.5 percent tariff on other telephone sets and private branch exchange switching apparatus, and a 9.2 percent tariff on vending machines.

Several actions have been taken by economic development organizations to respond to the impact of the Free Trade Agreement, including a comprehensive strategy initiated by New York's Department of Economic Development that includes export counseling, business marketing, and government procurement.

U.S.-Canada Trade and Investment

The U.S. and Canada are the world's largest trading partners, exchanging more than $151 billion worth of merchandise in 1988 (Figure 1). United States exports to Canada account for about 20 percent of total exports. Canada's dependence on the American market is much more profound. Nearly 78 percent of Canada's exports are accounted for by the U.S. market, and its exports to the U.S. make up about 20 percent of its GNP, while over 70 percent of its imports originate in the U.S.

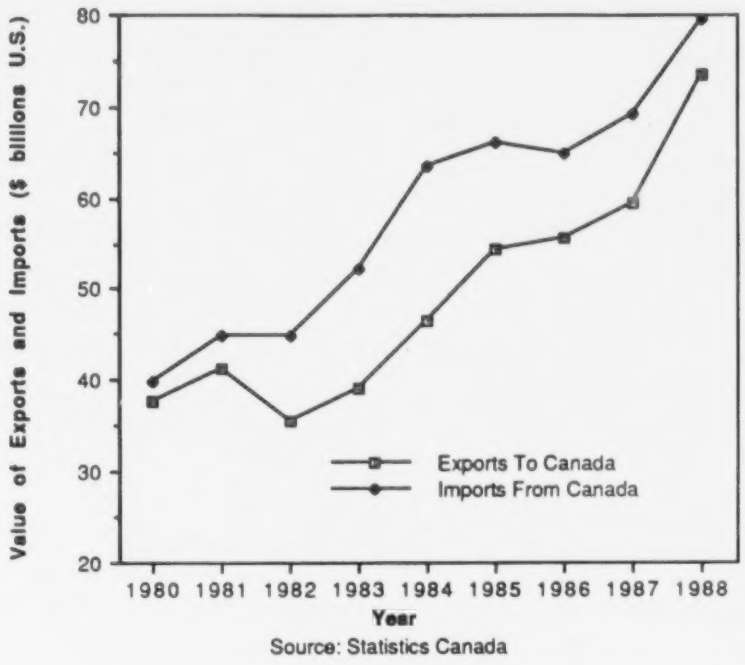
Bilateral trade in services is conservatively estimated at about $37.4 billion in 1988 and has consistently favored the U.S. In 1988, U.S. service exports to Canada amounted to about $26 billion, while imports reached $11.4 billion. After eroding marginally from a $7.3 billion surplus in 1980 to a $2.6 billion deficit in 1987, the total U.S. bilateral current account balance with Canada recovered in 1988, with a $3.6 billion surplus posted when trade in goods and services are included.

Of the $346 billion in foreign-owned property, plant, and equipment identified in the U.S. in 1987, Canadian-controlled assets accounted for $73 billion, or about 21 percent of the total. Canadian-owned firms employed approximately 590,000 workers, or about one-fifth of the more than three million total Americans working for foreign firms.

Factors Influencing Trade

Two factors have been major determinants in the volume of trade and investment between the U.S. and Canada: exchange rates and the 1965 Automotive Agreement (Schott 1988).

Figure 1
U.S. Commodity Trade With Canada 1980-1988



Source: Statistics Canada

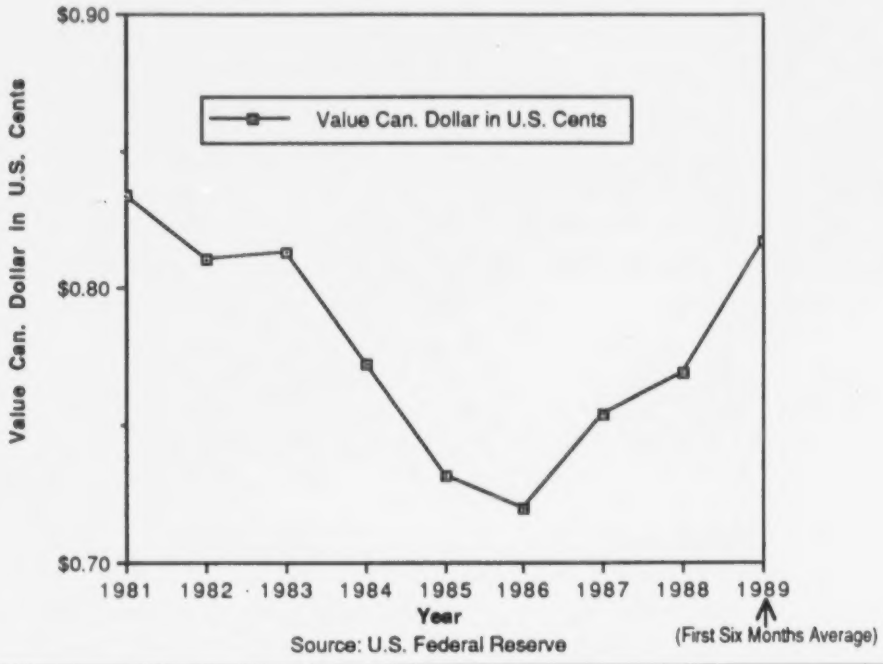
Exchange rate fluctuations have had a profound effect on cross-border trade and investment, more so than between some other nations because choices between direct investments and direct exports as a trading option are easier to make between two nations sharing a large border. Thus, minor fluctuations in currency values may change individual firm decisions regarding exports versus direct foreign investments (Figure 2).

Two-way trade is also greatly affected by the U.S.-Canadian Automotive Products Trade Agreement negotiated in 1965, which provides for duty-free passage of automotive parts between the two countries. This agreement resulted in increased production in Canada by the "big three" automakers and also increased the already dominant role of autos and parts as the major component of U.S.-Canadian commodity trade. In addition, the agreement may have strengthened the North American automobile industry vis-à-vis foreign competition (see Schott 1988).

New York-Canada Trade and Investment

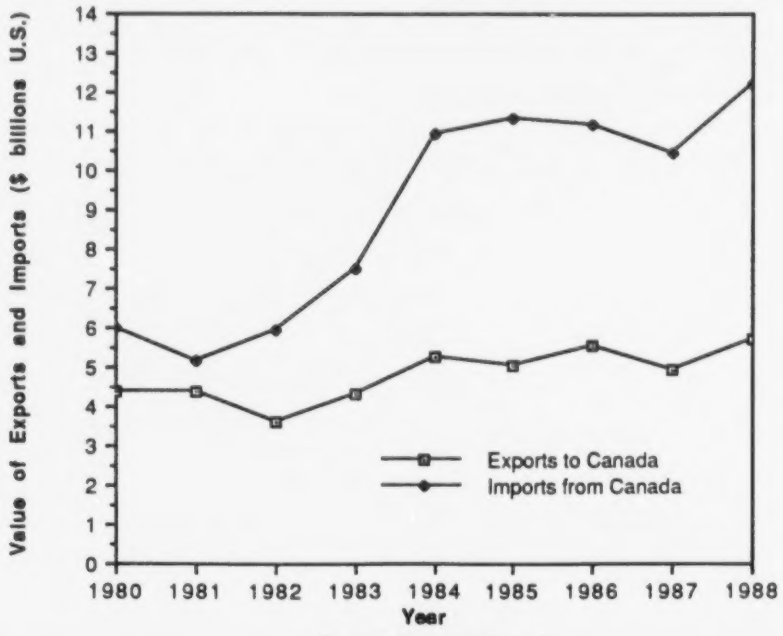
According to Statistics Canada's International Trade Division, commodity trade between New York and Canada totaled about $17 billion in 1988, over 10 percent of total U.S. trade with

Figure 2
Canadian Dollar Value in U.S. Cents 1981- 1989



Source: U.S. Federal Reserve

Figure 3
New York State Commodity Trade With Canada 1980-1988



Source: Statistics Canada

Table 1. Merchandise Trade Between New York and Canada, 1988.

N.Y. Imports From Canada		*N.Y. Exports to Canada*	
Product	*Amount (Millions)*	*Product*	*Amount (Millions)*
Passenger Autos and Chassis	$3,957	Motor Vehicle Parts/Engines	$548
Wood Pulp and Newsprint	847	Other Telecommunications Eq.	340
Aluminum	668	Aluminum	314
Precious Metals	632	Electronic Computers	297
Trucks and Tractors	562	Electronic Tubes/Semiconductors	264
Natural Gas	424	Photographic Goods	264
Motor Vehicles Parts/Engines	323	Books/Periodical/Printed Matter	247
Lumber/Other Wood Products	270	Other Metals in Ores	178
Crude Petroleum	253	Paper and Paperboard	107
Electricity	245	Passenger Autos and Chassis	104
Other	4,038	Other	3,032
Total	$12,219		$5,695

Source: Statistics Canada: International Trade Division

Canada (Figure 3). While Statistics Canada data suggest that New York imports twice as many goods from Canada as it exports, trade figures may be somewhat skewed in Canada's favor because of the difficulty in accounting for goods shipped into New York customs districts that are actually bound for other states, and the failure of trade statistical gathering techniques to properly allocate the value added to products by state (see the footnote to Data Sources, p. 21).

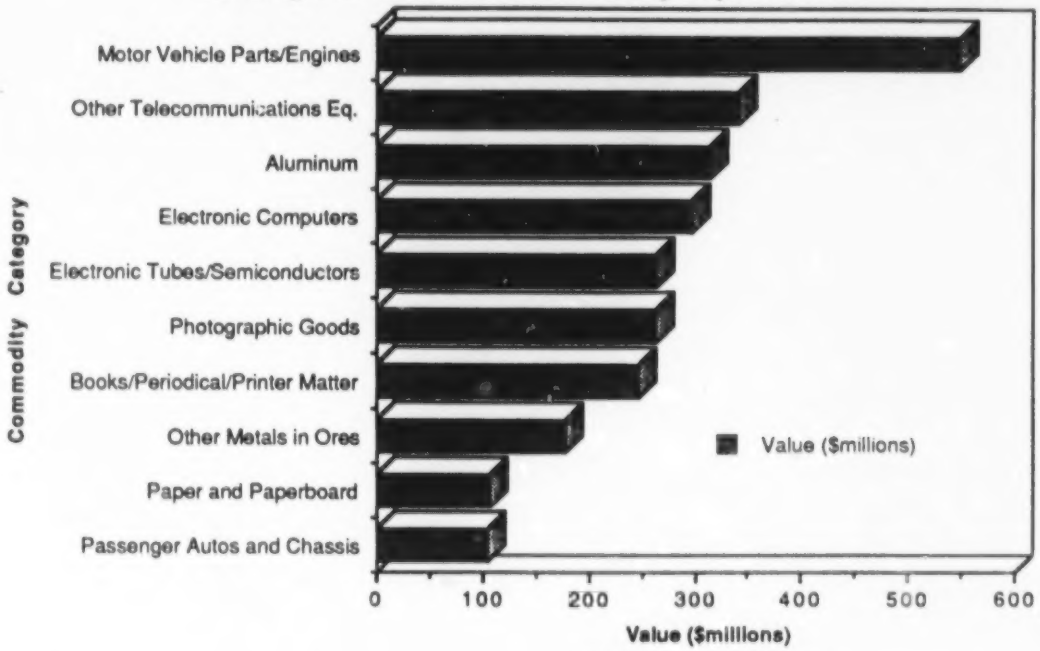
In 1988, leading New York exports to Canada included motor vehicle parts andengines; other telecommunications equipment; aluminum; electronic computers; electronic tubes and semiconductors; photographic goods; books, periodicals, and other printed matter; other metals in ores; paper and paperboard; and passenger autos and chassis (Figure 4).

Dominant Canadian exports to New York included automobiles (worth almost $4 billion); wood pulp and newsprint; aluminum; precious metals; trucks and tractors; natural gas; motor vehicle parts and engines; lumber and wood products; crude petroleum and electricity (Figure 5).

Of the $26 billion in service exports from the U.S. to Canada in 1988, at least one-tenth, and perhaps as much as one-fifth, can be attributed to New York sales. (Service trade figures are not compiled nor maintained on the state level.)

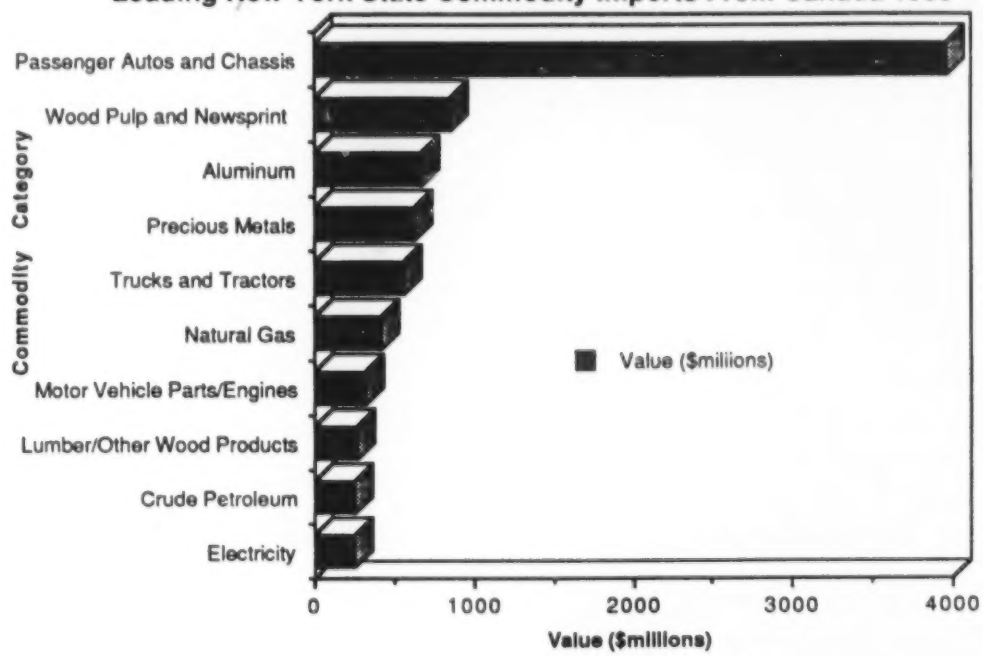
New York-Canada cross-border investment is also extensive. Canada's investment position in New York accounts for nearly one-quarter of total foreign direct investment in the State. According to the Bureau of Economic Analysis (BEA), in 1987 the gross book value of Canadian-owned property, plant, and equipment in New York was assessed at $5.203 billion (Figure 6). BEA identified 185 Canadian affiliates with property, plant, and equipment in New York, together employing more than 39,000 New Yorkers.

Figure 4
Leading New York State Commodity Exports To Canada 1988



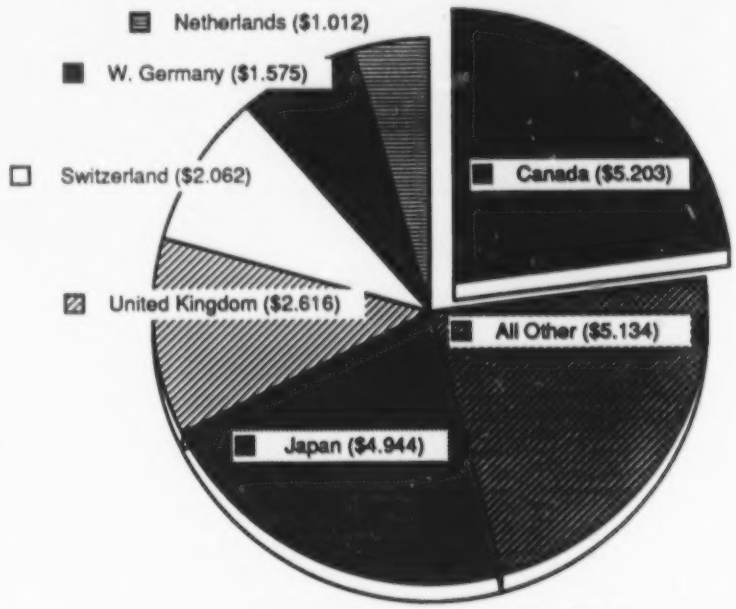
Source: Statistics Canada

Figure 5
Leading New York State Commodity Imports From Canada 1988



Source: Statistics Canada

Figure 6
Aggregate Foreign Investment in New York
By Leading Country of Origin 1987 ($billions)



Source: U.S. Bureau of Economic Analysis

In some regions of the State, the influence of trade and investment with Canada is especially important: northern and western New York derive significant shares of their total income and employment from their economic relationship with Canada. The North Country Economic Research Center at Potsdam College estimates that two-thirds of all new manufacturing jobs created in Clinton County in the 1980s resulted from foreign investment and that four-fifths of that investment could be traced to Canadian sources. In western New York, recent economic growth has been partially a result of significant new Canadian investment in financial services, manufacturing, and distribution.

Moreover, it may well be that overall, Canadian investment has more beneficial income and employment effects than direct investment from other countries. Harrington and Barnas (1987) found that in upstate "metro and nonmetro" regions, "*Canadian investment was overwhelmingly via new firms*"—85 and 90 percent in the respective regions, compared with 65 and 72 percent new firms for foreign investment overall" (p. 16).

Economic Impact of the FTA on the U.S.

Economists who have examined the macroeconomic impact of the Free Trade Agreement predict increased growth in both the U.S. and Canada under the FTA, although Canada, given

its relatively small economy and the dramatic influence of increased access to the enormous American market, might benefit more. Over the next ten years, growth in Canada could increase by as much as five percent (above the otherwise expected rate), while the U.S. GNP will likely increase by less than one percent.

The short-term impact on the American side is estimated to be modest except in specific regions and sectors, such as border states, or regions producing heavily protected commodities. Real investment in the United States is expected to increase only marginally: The President's Council of Economic Advisors predicts that the economic gains in the U.S will be between $1.1 billion and $2.9 billion. An analysis by the U.S. Department of Commerce estimates that the agreement will result in an increase of $25 billion in two-way commodity trade in the first five years.

Another study suggests the U.S economy should add approximately 32,000 additional jobs as a result of the $1.3 billion improvement in the balance of payments on dutiable trade that could result from the FTA. A New York Telephone analysis suggests much more sizeable gains: Using the INFORUM International Input-Output Model developed at the University of Maryland, New York Tel predicts that the FTA will increase U.S. GNP by approximately .4 percent, creating up to 650,000 new jobs.

Economic Impact of the FTA on New York

The impact of the Canada-U.S. Free Trade Agreement on New York's economy is difficult to estimate precisely. In aggregate, however, there will be many modest benefits, with few significant disruptions. When combined with other major economic trends in the U.S. and Canada, such as the movement in currency exchanges, the deregulation of financial markets, the harmonization of technical standards and environmental requirements, and the increase in joint scientific and cultural exchanges and projects, the FTA represents a significant catalyst to an already rapidly integrating North American market. Located in a strategic position with access to the industrial corridor of Canada and the U.S., New York is uniquely situated to reap some substantial economic benefits from this growing integration, and its chief symbol, the FTA. In real terms, the economic impact of the FTA on New York State will be more significant than the impact on many other states because of New York's proximity to the economic and population center of Canada, the large amount of border travel between the State and Canada, the large volume of trade and investment with Canada, and the concentration of industries that would be most influenced by trade liberalization with Canada. But because of the staging of tariff elimination and the relative size of the domestic market (New York's GSP is roughly equal to approximately fourfifths of Canada's total GDP), the proportional short run effects will be modest except in certain regions and industry sectors.

New York's industries and regions should fare well with the increased access to Canadian markets and the liberalization of cross-border travel and investment. Previously restricted financial, publishing, telecommunications, and electronics industries are especially well positioned to take advantage of the opening of Canadian markets. However, some "rationalization" in New York's economy will occur as formerly protected industries meet increased competition

from Canadian sources. Industries that may encounter a more competitive environment include some forms of agriculture, forest products and other raw materials. Investment restrictions, which limited the operation of American firms in Canada, were loosened under the FTA and energy costs to New York businesses should decline in the long run as already available Canadian power becomes cheaper with the lifting of export restrictions.

Based on an analysis of New York industries, their competitive strengths and weaknesses, and the relative reliance of major sectors and regions on trade and investment, New York can expect the following impact from the FTA:

- New York's trade balance with Canada, which according to Statistics Canada was $5 billion in deficit in 1988, should improve as New York firms secure increased access to the previously restrictive Canadian marketplace.

- Between 3,500 and 65,000 new jobs could be generated as a result of trade balance effects that will increase net New York exports to Canada (the former figure is based on an Institute for International Economics analysis and the latter based on the New York Telephone/INFORUM study, which factors in secondary effects).

- Several thousand additional jobs could be created by the general welfare effects that result from lower prices to producers, efficiency gains from economies of scale and rationalization of production.

- The electronics, computer, financial, and business services industries and firms catering to government procurement will benefit most.

- Some agriculture, manufacturing, natural resource, and energy firms will experience increased competition as a result of the agreement.

- Northern and western New York will experience the most significant direct impacts from the FTA, while other regions of the State, such as New York City, will experience few measurable effects;

- Overall, cross-border investment will increase.

- Smoother and more efficient border crossings by tourists, temporary business entrants and visitors should be fostered by the agreement.

- Traffic will increase on some major border crossings such as the Peace Bridge in Buffalo.

- Energy-intensive industries should benefit from the lower costs of energy, and energy-reliant firms should have additional reasons to locate in New York and New England, due to the unrestricted energy access guaranteed under the FTA.

Small manufacturers should benefit for three reasons. First, more Canadian government contracts are now open for bidding from American firms. The threshold of the contract value for the application for competitive bidding and other rules under the GATT (General Agreement on Tariffs and Trade) Government Procurement Code fell from $171,000 to $25,000 under the FTA, opening up roughly $400 million in Canadian contracts to bidding by American firms. Second, unlike large American firms, these small plants may yet have additional economies of scale to reap from the expanded market created by the FTA. This extension of production runs and specialization could result in expanded market sales generating "welfare" effects by increasing employment and income. Third, small manufacturers are considered "under exporters" and may use the opportunity of a relatively problem free post-FTA market in Canada to begin exporting, first to Canada and then to other foreign customers. One estimate suggests that although only about 10 percent of small firms actively export, as many as 75 percent produce a good in demand in foreign markets. The relatively similar Canadian market can serve as a "laboratory" for first-time exporters because it lacks many of the impediments to market access found in Europe and Asia.

Selected Industry Impact

High-technology Manufacturing

High-technology manufacturing products provide perhaps the greatest opportunities for growth in exports to Canada when the FTA is implemented. This is because overall demand for high-technology products is projected to remains strong, New York holds a competitive advantage in the production of many high-tech goods, and current Canadian tariffs and nontariff barriers on high tech products are high, so special price advantages should accrue to New York products sold in Canada when tariffs are removed. Also, increased manufacture and sale of high-tech industries that may result from the FTA will have especially positive economic consequences for the State because of the above-average wages and robust employment growth in high-technology production. Nationwide, the Corporate Technology Information Services reports that 40 percent of high-tech firms increased employment over the last year, with an average gain of about seven percent. Certain sectors experienced dramatic growth: telecommunications (24.5 percent), biotechnology (19 percent), and medical products (16 percent).

Canadian tariffs on data and word processors (computers) of 3.9 percent were eliminated on January 1st, as were duties on satellites and telephone sets that have tariffs of 10.3 and 17.5 percent, respectively. Additionally, the four percent duty on semiconductors and the 10.2-17.8 percent tariffs on various telecommunications equipment will be phased out under the accord.

Industries in New York affected by these tariff eliminations are the electric and electronic machinery industry, which currently employs approximately 150,000 people in New York, and includes electric industrial apparatus (13,000); household appliances (2,500); electric lighting and wiring (20,200); radio and television sets (4,500); communications equipment (51,300); electronic components (44,700) and other electrical products (12,500). In 1988, New York exported $297 million of electronic computers to Canada, $264 million in electronic tubes and

semiconductors, and $340 million in other telecommunications equipment. Although firms such as IBM, the largest business machines manufacturer in the world, with several plants and offices in New York, will benefit especially from these tariff eliminations, IBM's small suppliers may benefit even more.

More than 64,000 people are employed in New York's photographic equipment and supplies industry, and many more in other optics-related industries represented by firms such as Kodak, Xerox, and Bausch and Lomb. This broad sector, centered in New York City and the Rochester area, is one of our most successful manufacturing sectors in terms of both domestic and international sales. These industries should benefit from the elimination of a 10.2 percent Canadian tariff on color and instant print film, a 9.2 percent tariff on photo plates, and the removal of tariffs on a variety of other optical and photographic goods. In 1988, New York sold $84 million in unexposed photo film, plates, and paper to Canada and $179 million in other photographic goods.

Other Manufacturing

The automobile parts sector, currently employing 47,000 workers in New York should benefit from the staged ten-year elimination of the 9.2 percent Canadian tariff on auto parts and engines. In 1988, New York sold approximately $548 million in auto parts and engines to Canada. In 1988, Canada exported over $4.5 billion in automobiles, trucks, and tractors to New York, while New York exported a mere $104 million of these goods to Canada, contributing to an auto trade surplus for Canada of $4.3 billion, roughly two-thirds of Canada's total trade surplus with New York.

In the nonelectric machinery sector, gains should again be realized for New York industries, especially the growing accounting and office machinery sector, which employs 47,000 of the 130,000 total employees working in New York's machinery sector. Canadian tariffs, which range to 9.2 percent on machinery, will be eliminated over a five year period beginning in 1989.

Some of the highest Canadian tariffs are found on printed matter—28.6 percent on catalogs and 24.3 percent on printed advertising. New York's printing and publishing industry employs approximately 165,000 workers and should benefit from the five year staged elimination of these tariffs. In 1988, New York exported $110 million in newspapers, periodicals, and magazines; $119 million in books and pamphlets, and $19 million in other printed matter to Canada.

Several specific products have been identified by New York State trade specialists as good candidates for expansion of New York exports. These include furniture, where Canadian tariffs range to 15 percent, processed foods (tariffs of between 10 and 25 percent), household appliances (tariffs averaging 12.5 percent), textiles (tariffs to 25 percent), cotton apparel (tariffs to 25 percent) and specialty chemicals (tariffs to 12.5 percent).

Agricultural Products

The FTA provides some improvement for Canadian export prospects for New York agricultural and natural resource industries. Especially well positioned are nursery products such as sods

and turf, some produce, some dairy products, and processed foods. Many of the most egregious distortions to agriculture trade, however, were not addressed by the agreement. These nontariff barriers, such as quantitative restrictions, agricultural subsidies, purity, grading, labeling and health requirements, as well as some seasonal and permanent tariffs, are still a problem for cross-border trade in agriculture.

Problems in reaching international agricultural trade agreements are not unique to the FTA. The cohesion of the European Community, for example, has nearly collapsed on several occasions over the failure to reach consensus on major agricultural subsidy programs.

Tariffs on agricultural goods are relatively low, the principal form of trade protection being nontariff barriers (Lee, 1987). While the FTA would phase out regular and seasonal tariffs on agricultural products over ten years, either country would be able to impose a temporary duty on fresh fruits and vegetables if the import price fell below a certain average annual level for imports and imports threatened the domestic industry. Each country may therefore impose temporary tariffs during the post-harvest season for fresh fruits and vegetables, artificially resulting in increased consumption of domestic fresh produce in each country. This is consistent with the "snapback" allowances in the GATT.

In 1988, Canada exported about $434 million in agricultural goods to New York, the largest categories being fresh, chilled, or frozen meat; sugar preparations (maple sugar products); and miscellaneous beverages. New York exported $343 million in agricultural products to Canada, including $84 million in coffee; $26 million in refined sugar, molasses, and syrups; $19 million in orange juice concentrate; and $21 million in cocoa and chocolate.

The FTA leaves the Canadian dairy supply-management scheme and the U.S. dairy price support program intact. It had been hoped that two dairy products, ice cream and yogurt, which are currently dutiable at 12.5-15.5 percent and 15 percent, respectively, might stand to gain significantly from the agreement. However, Canada added these items to its import control list, which requires the Canadian Dairy Commission to issue a license for importation of these goods. A recent GATT ruling, following a U.S. challenge to the Canadian scheme, requires Canada to liberalize its dairy supply scheme. About 12,000 people work in New York's dairy-processing industry, with about 7,000 employed in the fluid milk sector, which encompasses yogurt, milk, and some other milk products.

Apples and grapes are the major products of the fruit and vegetables agricultural sector in New York. While exports of these products are not great in dollar terms, they do support specific farmers and regions with needed revenue. Approximately $19 million worth of grapes were shipped to Canada in 1988, and about $18 million of other fruits, mostly apples.

Agriculture-related employment takes two major forms in New York: farm employment (approximately 100,000 seasonal workers employed between July and October) and employment in the food-processing manufacturing sector (approximately 77,000 workers in 1987).

Forest Products

Forest products trade has been a constant source of friction between the U.S. and Canada. In fact, a dispute over Canadian exports of shakes and shingles nearly derailed the progress of

the FTA negotiations during the early stages of the talks. Two major issues that have emerged are the degree to which Canada subsidizes the harvesting of forest products and the standards that Canada imposes on building products that sometimes prevent use of U.S.-made products in Canadian construction.

The shakes and shingles dispute was resolved when Canada agreed to levy a ten-percent export duty on shakes and shingles to compensate for the alleged land sales subsidy. The second issue came to the forefront when Canada insisted that some American lumber was unfit for construction in Canada because of the large size of knots in trees harvested in the relatively warmer climate to the south. This lumber is thought to be inferior to small knotted wood in terms of insulation, so Canada imposed a regulation limiting its use (*New York Times*, June 7, 1988).

In 1988, major Canadian exports to New York of forest and forest-related products included softwood lumber ($200 million), wood pulp ($264 million), and newsprint paper ($582 million). In 1988, New York exported approximately $50 million in lumber to Canada and about $107 million in paper and paperboard. Canadian tariffs on plywood are eight percent or 9.2 percent depending on the type of product; wood pulp and newsprint paper are generally free of duty.

The impact of the FTA on the New York's forest-products industry might be expected to be negative because Canadian subsidy schemes were left somewhat intact by the FTA. However, many New York wood product producers depend on raw material from Canada, such as wood pulp and softwood lumber, so whether or not the final product is more or less competitively positioned, the cost of manufacturing that product may decline as U.S. tariffs on the import of the raw material are eliminated.

Alcoholic Beverages

A major disappointment for New York is the failure of the FTA to take on provincial protectionism of beer, wine, and liquor production. While beer was specifically excluded from the agreement, it was initially thought that wine and liquor exports would benefit from provisions of the FTA that mandate nondiscriminatory access to the Canadian market. While trade in liquor was improved by the FTA's elimination of discriminatory mark ups on imported wines and liquors, provincial interpretations of the agreement's provisions as evidenced by actions by the Quebec Liquor Board suggests that opportunities for expanded New York wine sales in Canada have improved only marginally.

In Canada, manufacture, distribution, and final sales of wine and liquor are controlled by provincial liquor boards. In Ontario, the wine provisions of the agreement have been challenged by the province because the provincial leaders are concerned for the small fledgling industry there. Of 570 imported wines listed, only 42 are American, most from California. In Quebec, where consumption of wine is twice the Canadian national average, the Quebec Liquor Board and the Société des Alcohol du Quebec (SAQ) control importation and distribution of alcohol in the province. Imports had faced an automatic mark up of 450 percent before they are sent to outlets for distribution. (A $30 case of New York State wine becomes $135 U.S. or, $170 Canadian). These discriminatory mark ups are to be eliminated under the FTA.

The QLB recently announced a new policy whereby imported wines must meet a minimum volume sale requirement to be "listed"—e.g., sold—in the provincial liquor stores. Shipments to Quebec are paid by the QLB on a consignment basis, and all wines must meet a sales quota of $159,000 per year for any listed wine, with the producer financing the return of all unsold product. This policy effectively eliminates all American wines currently listed with the QLB. Also, imported wines often face inferior placement on SAQ store shelves. Although New York is presently represented by only one wine maker in Quebec, Manischewitz, the resurgence of the domestic wine industry and the FTA made New York wine producers optimistic about the prospects for increased wine sales in Canada. Recent action by the GATT and the filing of a FTA noncompliance case by the U.S., suggests that Canadian provinces, including Quebec, will yet have to disassemble some of the most egregious provincial trade distortion in wines and liquor before substantial market access is accorded to New York wine producers.

Energy

The FTA provides significant safeguards for the free flow of energy between the U.S. and Canada. These provisions are especially beneficial to northeast industrial states like New York that rely on Canadian energy to supply increasing portions of their energy needs. Fortunately for New York, American negotiators stressed access to Canadian sources, to the consternation of some U.S. energy producing states, who lobbied heavily to include protection of those industries in the bill implementing the agreement.

In 1988, New York exported approximately $27 million in fuel oil to Canada, but little else in other forms of energy. By contrast, Canada exported $253 million in crude petroleum, $424 million in natural gas, and $245 million in electricity to New York. Most significantly, New York signed a sales agreement earlier this year with Hydro-Quebec that will bring $13.7 billion worth of electricity to New York over 20 years.

Concern in New York over the viability of nuclear power has increased interest in hydroelectricity as an alternative to meet growing energy needs. When the Hydro-Quebec deal is fully implemented, New York's reliance on Quebec hydropower will increase as a percent of total energy and New York can be more secure in reaching agreements such as the Hydro-Quebec deal under the FTA, because even under a shortage or shock situation, Canada will have to provide a constant proportional share of energy to the U.S.

Travel and Tourism

The travel and tourism industries in New York should benefit from a number of provisions of the FTA. First, high tariff and nontariff barriers placed on the circulation of U.S. tourism and travel information in Canada will be removed. This will mean greater and more cost-effective advertisement of New York tourism locations and services in Canada. Second, Canadian shoppers who travel to New York to buy clothing and other consumer goods will no longer have to pay duties on those products when re-entering Canada (although they will continue to pay Canadian excise taxes). This should lead to more frequent and longer excursions by Canadian purchasers to New York. Third, the liberalized and relaxed regulations pertaining to tempo-

rary entry of business persons may mean more business-related visits by Canadians to New York and greater use of New York convention facilities, regional airports, and, of course, more activity in the hospitality trades overall. Tourism is, by some definitions, the second largest New York industry, with nearly 700,000 New Yorkers employed in travel-related occupations. In 1988, more than 17 million visitors crossed from Canada into New York, with more than 2.35 million remaining for one night or more, two-thirds of the total out-of-country visitors.

Services

New York's financial and business services industries stand to benefit from a number of provisions of the FTA.

In financial services, advantages should result from the agreement's explicit guarantees of national treatment for American financial institutions operating in Canada. Hence, Canada's ceiling on total nonresident group ownership of individual banks of 25 percent is lifted with respect to American ownership, although the 10 percent limit on individual ownership by Canadians or foreigners remains in place. The FTA, combined with further deregulation of Canadian financial service markets, should help New York firms compete more effectively north of the border. New York State financial services industries have experienced major growth over the last decade, adding significant employees to their roles and earning record-breaking profits, especially in securities activities.

More than 800,000 New Yorkers are now employed in the broadly defined finance, insurance and real estate (FIRE) sector, and several hundred thousand more in the supporting business services sectors of accounting, advertising, law, and management consulting. Most FIRE employees work in the New York City metropolitan area, although in real terms, proportional growth in upstate financial services has been greater. In Long Island, employment in the FIRE sector grew by 75 percent in the period 1974-1987, and in Westchester, Albany, and Buffalo, gains of 57 percent, 46 percent, and 37 percent were posted.

For New York City firms, increased employment should be experienced at the home office and branches in Canada and Buffalo-based institutions could capitalize on some of the geographic and economic advantages in order to reap benefits from the FTA. The FTA may also ease the likelihood of purchase of New York financial institutions by the enormous Canadian banks because of the reciprocal treatment afforded Canadian financial institutions under the FTA.

The business-services sector has experienced dynamic income and employment growth in New York State over the last decade. The FTA is a path-breaking accord in that it provides the first comprehensive treatment of trade in services of any major trading agreement and that it loosens traditionally restrictive investment barriers that are crucial to enhancing business services trade.

Over 2.2 million New Yorkers are employed in the services and miscellaneous sector including 508,000 in business services, 571,000 in health services, 104,000 in legal services, 214,000 in educational services, 215,000 in social services, 116,000 in membership services, 121,500 in miscellaneous services and 247,000 in other services.

Summary of Industry Impact

The reciprocal nature of the agreement requires that U.S. tariffs and nontariff barriers on Canadian goods will be lowered along with Canadian trade barriers, allowing for enhanced access to the New York marketplace by Canadian firms. It is important to note, however, that Canada's tariffs on dutiable goods average three times those of the U.S. (9.9 percent versus 3.3 percent), and for many commodities the gap is even wider. Also, nontariff barriers, the major form of protection in services, were more extensive in Canada prior to the agreement's enactment. New York should therefore be well positioned to compete with Canadian firms north and south of the border under the FTA.

Foreign Direct Investment

Direct Canadian investment (new facilities, acquisitions, and joint ventures) in New York has been particularly significant in the past few years, and has been instrumental in improving the sometimes difficult economic climate in some regions. Canadian investment is especially beneficial in that it has more often been "greenfield"—new plant and equipment—and less merger or acquisitions investment. Also, Canadian investment has sometimes resulted in the retooling or reopening of a dormant manufacturing plant, or the re-employment of displaced workers. Quebec Gear Works has announced the opening of a plant in Rouses Point and the rehiring of former employees of the recently closed Harris Corp plant there.

Some economic theory suggests that a principal reason for establishment of manufacturing or production facilities in a foreign market is to avoid the payment of tariffs levied on direct exports to that market. This would suggest that as tariff barriers are reduced under a free trade accord such as the FTA, Canadians would no longer manufacture and produce from New York locations, but source production back to Canada and simply export the product or service. Most analysts, however, have suggested that Canadian investment is motivated by a variety of factors including market information and proximity to consumers, transportation and distribution networks and labor availability, stability, and cost. These factors, combined with the gradual staging of the tariff reductions, imply that Canadian-direct investment will continue to be a positive force in regional development.

Survey research by Gandhi (1986), found that tariff barriers were relatively unimportant on the list of factors influencing the decision by Canadian firms to locate in New York. Gandhi found that nearness to the parent company, potential growth in the U.S., location in the area, transportation highways, nearness to customers, and trainable labor all came before tariff barriers as reasons for a New York location choice (Table 2).

Canadian concern about disinvestment by American firms may be better founded. There is some evidence that American firms may consolidate some operations in the U.S. when Canadian tariff and nontariff restrictions are no longer factored into the location equation. Also, strategic consultants in Canada are reportedly recommending to their medium-sized manufacturing clients to consider a U.S. location when adding a new plant as the FTA is implemented (Pettigrew 1988). These analysts predict that Canadian firms will need to have

Table 2. Importance of Locational Factors of Canadian Firms in New York.

Factor	*Percent Responding Extremely or Very Important*
Extremely Important	
Nearness to Parent	81%
Potential Growth in U.S.	79%
Location in the Area	77%
Transportation Highways	64%
Moderately Important	
Nearness to Customers in U.S.	39%
Trainable Labor	39%
U.S.-Canadian Tariff	34%
Skilled Labor	32%

Source: Gandhi, 1986, p. 217.

a U.S. location to maintain a market share and to mitigate some of the productivity disadvantages that will be accentuated when tariff protection is eliminated (Tables 3 and 4).

The attractiveness of Canadian and U.S. locations for new investment from third-party countries may be enhanced by the FTA as a North American Economic Community becomes closer to reality. Some analysts predict that the Buffalo area may emerge as a center of trading activity for firms wishing to maintain a U.S. location as well as having quick and easy access to the growing Toronto area market.

Selected Regional Impacts: Focus on Western and Northern New York

The Canada-United States Free Trade Agreement will have a variety of impacts on the regional economies of New York State. Analysis of the interaction between regional economics and international trade and investment is difficult and tenuous; however, some empirical observations can be made concerning the relative dependency of different regions of the State on Canadian trade and investment, and therefore the potential impact of the FTA.

The economies of Western New York and the North Country present a special situation with respect to analysis of the Free Trade Agreement. Because of their border locations close to the nexus of Canadian industry and population, the significant commercial and tourist border travel, the concentration of Canadian direct investments, and the active customs, shipping, freight forwarding, immigration, and other border-related activities, these two

Table 3. Productivity Growth by Industrial Sector
U.S. and Canada 1973-1984*
(1973 = 100)

Industry	*Canada 1984*	*U.S. 1984*
Tobacco	118.0	108.9
Leather	152.1	119.8
Textiles	171.3	181.2
Clothing	137.1	134.8
Wood	171.1	124.1
Furniture	95.2	124.7
Paper	102.6	134.9
Publishing	125.6	96.0
Primary metals	111.5	89.3
Fabricated metals	111.4	121.5
Machinery except electrical	116.1	161.8
Transportation equipment	132.5	116.9
Electrical and electronics	207.3	156.9
Nonmetallic mineral products	102.7	116.9
Refined petroleum and coal products	98.3	97.5
Chemicals	140.0	132.8
Other manufacturing	120.9	140.7
Food and beverage	112.4	125.6
Rubber and plastics	137.5	116.7
All manufacturing	129.4	126.5
Sum of industries	127.3	122.0

* This table shows only productivity growth within each country and does not reflect real productivity levels between the U.S. and Canada. Level comparisons are not made because of technical difficulties in determining purchasing power parity for individual industries.
Source: U.S. Department of Labor, unpublished data.

Table 4. Level of Productivity Measured by Real GDP per Capita
Canada Compared to the U.S., 1950-1987
(U.S. = 100).*

	Canada
1950	70.4
1960	72.9
1970	79.2
1980	93.4
1981	94.8
1982	93.9
1983	93.4
1984	92.7
1985	93.6
1986	93.6
1987	94.1

* Note that although the U.S. still leads Canada in overall productivity as measured by GDP per capita, in the period 1950-1987, Canada has closed most of the productivity gap.
Source: U.S. Department of Labor, unpublished data.

regions should be much more affected by the Free Trade Agreement than other regions of the State.

One view is that the elimination of customs duties reduces the relevance of borders and thus border activity. On the other hand, the FTA requires importers to verify the origin of imported goods in order to received duty-reduced status, thus adding a new documentation requirement, and although immigration procedures are streamlined under the FTA, immigration officials will still be active in screening prospective border entrants.

As mentioned above, concerns that the impetus for Canadian investment in border areas would be reduced with the elimination of tariffs is also unfounded. Canadian investment has been shown to stem from a combination of factors (especially labor availability and cost), and the many provisions of the Free Trade Agreement will be implemented slowly, so in the short term the agreement would be unlikely to materially affect the volume of Canadian direct investment in border areas. Regional empirical research has confirmed this conclusion. For example, as of July 1989, the Metro Buffalo Alliance reports 54 new Canadian investments in Western New York since implementation of the Free Trade Agreement on January 1.

Western New York should also benefit from increased export opportunities, especially in services. Business and financial service employment comprises an increasing share of total Western New York employment as manufacturing has declined in importance. While 101,000 people were employed in the manufacturing division in the Buffalo metropolitan statistical area in 1987, over 120,000 were employed in services, and an additional 27,000 in the FIRE sector, 99,000 in retail trade, and 83,000 in government. Within the services division, 53,000 were employed in health services and 41,000 in educational services.

The pre-eminence of major medical research and service institutions may attract greater interest by Canadian biotechnology and health firms in Western New York. In financial services, regional firms such as Goldome and Empire of America may be able to penetrate the increasingly deregulated Toronto area market and many law firms have opened offices in Toronto to take advantage of increased activity resulting from the FTA. Some analysts predict the Buffalo area may emerge as a center of trading activity for firms wishing to maintain a U.S. location, but also desiring quick and easy access to the growing Toronto area market.

In the Northern economic area, defined as Clinton, Essex, Franklin, St. Lawrence, Jefferson, and Lewis counties, employment is concentrated in manufacturing (20,000), retail trade (26,000), and services (26,000). Within manufacturing, where more than 430 "reporting units" were identified, the paper and allied products (5,459) and primary metal (3,158) industries are the two most significant employers. Over 9,000 Northern New Yorkers are employed in eating and drinking places, a subdivision of the retail trade division and another 2,200 in hotels, motels, and lodging, a subdivision of the services division. It should be noted that these figures are for average year-round employment, and employment in the lodging category surges to well above 3,000 during the high seasons.

Some analysts suggest that the entire border area separating New York and Canada will no longer be seen as an obstruction to the flow of capital. These frontiers will instead emerge as the core of a now expanded North American market instead of the periphery of two distinct economies. This theory would suggest continued and vigorous investment in the North Country

and Western New York by Canadian investors, additional growth in the small manufacturing sector, and an overall stimulus to the economic base of the regions as a whole.

Impact on the Firm

Three major factors will influence the competitive position of New York businesses once the FTA is fully implemented: the relative size and rate of tariff reduction, comparative productivity, and exchange rates.

Overall, U.S. productivity in manufacturing as measured by GDP per capita exceeds that of Canada, although decreasingly so. As Tables 3 and 4 show, Canadian productivity is growing faster industry by industry than U.S. productivity, although the aggregate figures show that because the U.S. had a base-level advantage, it still retains a six percent lead overall.

The position of New York business owners in domestic and Canadian markets will be directly affected by Canadian firms' ability to adjust and increase productivity as tariffs are lifted. Because Canadian tariffs are roughly three times those of the U.S., Canadian businesses will experience more of a "shock" when tariffs are removed. Hence, the FTA will force Canadian firms to adjust and become more productive, and New York firms must continue to invest in productivity-improving measures to insure a solid place in the new economic climate, once the FTA is fully implemented.

The position of New York-based businesses in domestic and Canadian markets will be affected by the relative exchange rates between the U.S. and Canada in the post-FTA environment, and how the economic integration associated with the FTA affects exchange rates, and as a result, the price of U.S. goods in Canada and Canadian goods in the U.S.

The Canadian dollar fell and then rose against American currency throughout the 1980s, but the shifts were not nearly as dramatic, nor were they necessarily in the same direction, as the movements of other nations' currency vis-à-vis the U.S. dollar (Figure 2). This is because Canadian monetary policies are so inextricably linked to U.S. policy, and because Canada is committed to a relatively stable trading range for its currency in relation to the U.S. The reasons for this are obvious: With 20 percent of its total GNP generated from exports to the U.S., currency stabilization with the U.S. dollar is paramount to successful economic growth. Recently, the Canadian dollar has inched up against U.S. currency, with brief periods of decline when markets became nervous over the possibility that the FTA might not be approved in Canada. Williamson estimated in 1986 that the fundamental equilibrium exchange rate (FEER) for the Canadian dollar was about 74 cents, higher than the 71.4 cents registered at that time. The Canadian dollar has since exceeded that FEER estimate, reaching 84 U.S. cents in the summer of 1989, and there is reason to believe that a short-term depreciation in the Canadian dollar may be observed during the early years of the FTA's implementation, but that long-term currency rates should remain somewhat stable, at least more so than with our other major trading partners. New York businesses should therefore be confident that a relatively stable U.S./Canadian dollar trading range will be maintained in the post-FTA environment, ensuring a predictable and stable export and investment climate.

With the lowering of tariff and nontariff barriers, current levels of domestic market share cannot be taken for granted. As the Canadian and American markets integrate, businesses that traditionally relied on solely domestic sales may find their previously exclusive market shares threatened by increased competition from Canadian suppliers. Also, these firms may be able to penetrate the markets previously served by Canadian companies by exploiting the reductions in Canadian tariffs and the greater relative productivity of American firms once barriers are eliminated. Increased licensing, distribution direct investment, and merger and acquisitions strategies may be pursued to gain a foothold in these opening markets.

Strategic Firm-level Response

New York firms seeking to maximize benefits from the FTA must adopt specific strategies to ensure their competitive position in the post-FTA environment. For new-to-export firms, these strategies include identifying relevant tariffs and nontariff barriers, establishing current duties and elimination schedules, targeting specific Canadian market niches for increased export growth and gaining familiarity with documentation, labeling, and packaging requirements that are necessary to begin exporting to Canada. These firms must also make contact with lawyers, accountants, custom-house brokers, freight-forwarders, and public and private export assistance professionals who can help with the export process. For firms already exporting to Canada, strategies may include increasing international sales staff, developing additional licensing and distributions arrangements, and forming joint ventures and cooperative relationships to capitalize on Canada's opening markets.

For larger firms, strategies may have already taken place with the establishment of facilities in Canada, or via a merger with, or acquisition of, a Canadian partner. For medium-sized firms, strategies might include expanding the international sales staff, modifying the product to Canadian specifications, such as metric measurement or French language labeling, and considering greater emphasis on refining one product to maximize scale economies, specialization and production advantages. Concentrating on "core" business products or services will be one strategy pursued by all firms to ensure a place in the larger, more "rationalized" market.

Small firms face the greatest opportunities and challenges under the FTA. Small niche suppliers may find that they have a direct Canadian competitor they were previously unaware of. U.S. firms will have a short-term advantage because Canadian tariffs are generally higher than U.S. tariffs, and as mentioned before, U.S. productivity is generally higher than in Canada. However, this window of opportunity will not be open for long, as Canadian firms quickly make the adjustment to increased competition by streamlining and specializing production.

If small companies determine that greater opportunities will unfold in the Canadian market, they may consider immediately establishing a relationship with a distributor in Canada, or an export trading or management company. Determining the position of direct competitors is also important. Often, similar products may be complementary and not directly

competitive, and this determination might lead to cooperative relationships such as reciprocal distribution, licensing, or merger.

New York State and Federal international trade and economic development professionals may be able to help with specific information, technical and financial assistance. Firms should take advantage of the services of the U.S. Department of Commerce—Canada Office in Washington and U.S. and Foreign Commercial Service District offices, and the Department of Economic Development's Regional Offices and International Division, as well as local government and private assistance.

New York State's Role

States have taken an increasing and expanded role in economic development, and international trade is one area where they have been particularly active. Through the Governor's Council on Trade and Competitiveness, the World Trade Council and the Department of Economic Development, New York has been vocal in trade policy debates, and an advocate for increasing New York's share of global markets.

Governor Cuomo has been generally supportive of the Free Trade Agreement and voted affirmatively when the National Governor's Association passed a resolution endorsing the FTA. The Governor's staff worked with the NGA to ensure that the implementing legislation reflected State as well as national interest by urging that rules governing possible federal preemption of state law be fair and workable.

New York has the most active presence in Canada of any state. The State Department of Economic Development has been instrumental in helping New York businesses penetrate Canadian markets and attracting Canadian investment to the State. Specific programs and strategies have been initiated by Governor Cuomo and Director of Economic Development Vincent Tese to help New York take advantage of expanded opportunities under the FTA. They include:

- The initiation of a comprehensive programmatic response to the Canada-U.S. Free Trade Agreement including economic impact analysis, publicity, and helping firms take advantage of the new market opportunities presented by the FTA.

- The creation of an interagency working group to coordinate the State's overall response to the FTA.

- Regional education and training seminars to familiarize New York State businesses with the agreement and its impact on their business practices.

- The development of industry and region-specific strategies and marketing plans in conjunction with regional development agencies, chambers of commerce, private cor-

porations, and universities to help New York industries and regions maximize benefits from the FTA, and to mitigate any potential negative impacts.

- The funding of export trade projects that focus specifically on New York's trade and investment with Canada, such as the Rochester Chamber of Commerce program to help businesses in a nine-county region begin or expand exports to Canada.

Postscript

On January 1, 1991, the Canada-U.S. Free Trade Agreement had been in place for two years. In general, the forecasted economic impacts on the U.S., Canadian, and New York State economies closely mirrored actual experience. While the consequences of the Canadian and U.S. recessions have offset some of the benefits for the two countries, the overall objectives of the Agreement are being achieved. By most measures, the Agreement is a sucess: Goods, services, capital, and labor are moving across the border more freely and in greater quantities; disputes have been few, and resolved easily; requests for the accelerated removal of tariffs have been many, and surprisingly noncontroversial. Most importantly, the agreement has provided a positive contribution to the multilateral trade negotiations and has demonstrated that bilateral agreements are successful in urging progress in the multilateral setting. Two-way agreements may also be extended to additional participants, as has been suggested with the prospects for a negotiated three-way agreement with Mexico.

For New York, the impact of the FTA has been more substantial on retail trade, travel and tourism, and investment, than it has on manufactured exports. Indeed, in Western New York, the economy has profited handsomely from Canadian investment and its geographic situation as one of the busiest border crossings. How much of this increased activity is attributable to the Agreement itself, as opposed to a natural and longstanding trend of economic integration between Western New York and Southern Ontario, will continue to be a topic of debate.

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[1] Throughout this report, data on New York-Canada trade are drawn from these two Statistics Canada series. The problems of allocating national trade data to individual states are widely recognized, and therefore this series should be viewed skeptically. Inaccuracies result from the difficulty in accounting for goods shipped into individual customs districts that are actually bound for other states, and the failure of trade statistical-gathering techniques to properly allocate the value added to products by state. These problems pose particular difficulties in measuring New York-Canada trade. While the Statistics Canada series is imperfect, an alternative U.S. Census data series on state exports is thought to be even less accurate. Readers should view the data as a measure of the relative distribution of trade among commodities and one indicator of overall trends over time. The data should not be interpreted as a precise measure of New York-Canada commodity trade.

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